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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

DEC 11 0 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )  
 )  
Amendment of Parts 32 and 64 of )  
the Commission's Rules to Account )  
for Transactions Between Carriers )  
and Their Nonregulated Affiliates )

CC Docket No. 93-251

U S WEST COMMENTS

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SUMMARY

In its Notice, the Commission proposes to reevaluate its affiliate transaction rules for common carriers which set forth federal accounting requirements for transactions between carriers and their nonregulated affiliates. The Commission proposes to amend these rules to enhance its ability to keep carriers from imposing the costs of nonregulated activities on interstate ratepayers by cross-subsidizing and to keep ratepayers from being harmed by carrier imprudence.

U S WEST strongly opposes the Commission's proposals and urges the Commission to maintain its present safeguards as currently constituted. The Commission's actions -- to promulgate rules that are based upon erroneous and unsubstantiated assumptions -- would unnecessarily burden carriers and undermine past efforts to strike a balance between encouraging innovation, productivity and efficiency, and maintaining the necessary safeguards against cross-subsidization.

The present safeguards, when coupled with existing efficiency and productivity incentives, are sufficient to allay the Commission's concerns with regard to cross-subsidization and the protection of ratepayers.

In particular, U S WEST strongly opposes the Commission's proposal to add a fair market value requirement for services because such a requirement would be impractical, inefficient and unnecessary. Moreover, prevailing company pricing is a good measure of market value, and the Commission's proposal to adopt a

"bright line" test, premised upon the affiliate's "predominant purpose," would not be the appropriate method for ascertaining prevailing company pricing.

Finally, it would be premature for the Commission to promulgate its proposed rules prior to the resolution of its local exchange carriers price cap performance reviews in 1994.

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U S WEST COMMENTS

U S WEST, Inc. ("U S WEST"), through counsel and pursuant to the Federal Communications Commission's ("Commission") Notice of Proposed Rulemaking in the above-captioned docket,<sup>1</sup> hereby files its Comments on the Commission's Part 32 and 64 proposals.

I. INTRODUCTION

In its Notice, the Commission proposes to reevaluate its affiliate transaction rules for common carriers which set forth federal accounting requirements for transactions between carriers and their nonregulated affiliates.<sup>2</sup> The affiliate transaction rules are part of the Uniform System of Accounts ("USOA") the Commission has promulgated so that carriers will record their costs and revenues in a uniform and systematic manner.<sup>3</sup> This system generally requires carriers to record as costs and

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<sup>1</sup>In the Matter of Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, CC Docket No. 93-251, Notice of Proposed Rulemaking, FCC 93-453, rel. Oct. 20, 1993 ("Notice").

<sup>2</sup>Id. at 2 ¶ 1.

<sup>3</sup>Id. at 3 ¶ 2.

revenues the actual amounts they pay to and are entitled to receive from their suppliers and customers.<sup>4</sup> The rules also allow local exchange carriers ("LEC") entry into nonregulated services as long as the costs for such services are not borne by the ratepayers. Moreover, the rules serve as a safeguard to discourage opportunities, arising out of rate of return regulation, for LECs to cross-subsidize by overpricing regulated services to cover unregulated costs.<sup>5</sup>

The Commission proposes to amend these rules to enhance its ability to keep carriers from imposing the costs of nonregulated activities on interstate ratepayers and to keep ratepayers from being harmed by carrier imprudence.<sup>6</sup>

The Commission proposes to: a) restrict prevailing company pricing in affiliate transactions to situations in which the affiliate in the transaction sells at least seventy-five percent (75%) of its output to non-affiliates; and b) require that all affiliate transactions involving services, other than those provided pursuant to tariff or permitted to be recorded at

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<sup>4</sup>Id.

<sup>5</sup>See In the Matter of Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, 2 FCC Rcd. 1298, 1335 ¶ 292 ("Joint Cost Order"), Order on Reconsideration, 2 FCC Rcd. 6283 (1987) ("Joint Cost Reconsideration Order"), Order on Further Reconsideration, 3 FCC Rcd. 6701 (1988) ("Further Reconsideration Order"), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990). See also In the Matter of Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), Report and Order, 104 FCC 2d 958, 1074 ¶ 234 (1986) ("Computer III").

<sup>6</sup>Notice at 2 ¶ 1.

prevailing company prices, be recorded at the higher of cost or estimated fair market value when a carrier is the seller and at the lower of cost or estimated fair market value when the carrier is the purchaser.<sup>7</sup> This would result in identical valuation methods for assets and services.<sup>8</sup>

The Commission further proposes specific requirements for implementing the valuation methods, generally requiring carriers to calculate affiliate transaction costs using methods similar to those required for calculating interstate revenue requirements. Finally, the Commission asks for commenters to quantify the costs and benefits of each of the proposed costing methods and to suggest alternatives that may reduce costs or increase benefits.<sup>9</sup>

U S WEST acknowledges that the Commission, over time, has tried to strike a balance between encouraging consumer choice, new product development, optimum use of the network, technological progress,<sup>10</sup> and efficiency and productivity<sup>11</sup> on the one hand and maintaining necessary cost allocation safeguards against

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<sup>7</sup>Id. at 15 ¶ 34.

<sup>8</sup>Id. at 19 ¶ 45.

<sup>9</sup>Id. at 18 ¶ 43.

<sup>10</sup>See In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, Report and Order, 6 FCC Rcd. 7571, 7574 ¶ 5 (1991) ("Computer III Remand Order").

<sup>11</sup>See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd. 6786, 6787 ¶ 1 (1990) ("LEC Price Cap Order").



discrimination and cross-subsidization on the other.<sup>12</sup> However, while U S WEST supports the Commission's past efforts to align its safeguards with the significant changes occurring in the industry, U S WEST strongly believes, for the reasons presented below, that the Commission would undermine all of its efforts to strike this balance by adopting the measures proposed in the Notice.

U S WEST is concerned that the Commission is promulgating rules based upon erroneous and unsupported assumptions and believes today's present safeguards, when coupled with efficiency and productivity initiatives, are sufficient to discourage cross-subsidization and protect ratepayers. Moreover, U S WEST does not believe the Commission's actions are appropriate when weighed against the burden these proposals will place upon carriers. For example, the total amount of affiliate transactions subject to the Commission's rules is less than seven percent (7%) of the total operating expenses of U S WEST Communications, Inc. ("USWC"), U S WEST's regulated affiliate. Of this amount, only approximately twenty-five percent (25%) flows through the interstate ratemaking process. Thus, expenses from affiliate transactions amount to less than two percent (2%) of USWC's total operating expenses. This raises the question of the practicability of the Commission's promulgation of burdensome and detailed rules for such an insignificant amount of expense.

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<sup>12</sup>See Computer III Remand Order, 6 FCC Rcd. at 7574 ¶ 5.

In particular, the Commission should not require carriers to ascertain fair market value for all services. U S WEST will explain why prevailing company pricing is a good surrogate for market price and should be retained. U S WEST will also show why an affiliate's "predominant purpose," the underpinning for the Commission's "bright line" test for ascertaining when prevailing company price should be used,<sup>13</sup> misses the mark.

In addition, the adoption of the Commission's proposed rules at this time would be premature, pending the resolution of its LEC price cap performance reviews in 1994. Finally, U S WEST will discuss why other features of the Notice which deal with chaining, quantification of costs, cost apportionment, alternative valuation methods, nonregulated operations and true-ups are problematic to U S WEST should they be adopted.

II. THE COMMISSION SHOULD DELAY ITS DECISION IN THE NOTICE UNTIL IT COMPLETES ITS LEC PRICE CAP PERFORMANCE REVIEW IN 1994

Under the Commission's LEC Price Cap Order, the Commission scheduled a review in 1994 to evaluate each incentive-based system implemented and the individual LEC's performance under it.<sup>14</sup> Although the Commission stated that it intended to retain existing policies and rules in several areas, such as its joint cost rules and the USOA after such reviews,<sup>15</sup> U S WEST believes

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<sup>13</sup>Notice at 9 ¶ 21.

<sup>14</sup>LEC Price Cap Order, 5 FCC Rcd. at 6834 ¶ 385.

<sup>15</sup>Id. at 6835 ¶ 396.

that the Commission would be in a better position to assess whether it should embrace a different set of rules in this proceeding once its performance reviews of the LECs are completed for the following reasons: First, the Commission will then have a better discernment of LEC pricing, earnings, service quality and technological progressiveness under price cap regulations which may be useful to it in ascertaining to what extent, if any, it should amend its existing accounting rules.

Second, one result of the Commission's review could be to significantly modify the sharing mechanism inherent in price cap regulation. If this were to happen, the Commission would probably need to modify its cost allocation safeguards. Consequently, it would not be efficient or cost effective for the Commission to amend the existing rules in this proceeding only to amend them again after completing its price cap performance reviews. Accordingly, U S WEST recommends that the Commission delay its decision in this proceeding until after those reviews are completed.

### III. PRESENT SAFEGUARDS ARE SUFFICIENT TO DISCOURAGE CROSS-SUBSIDIZATION AND PROTECT RATEPAYERS

In its Notice, the Commission proposes to amend the rules adopted in its Joint Cost proceeding which set forth federal accounting requirements for transactions between carriers and their nonregulated affiliates.<sup>16</sup> The Commission proposes to

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<sup>16</sup>Notice at 2 ¶ 1.

amend these rules to enhance its ability to keep carriers from imposing the costs of nonregulated activities on interstate ratepayers and to keep ratepayers from being harmed by carrier imprudence.<sup>17</sup> It would appear that the Commission's position is based upon the presumption that the accounting rules, as presently constituted, are insufficient to protect ratepayers from carrier imprudence when carriers do business with their affiliates. Such a presumption is factually unsubstantiated and without basis.

In accordance with the Joint Cost Order, U S WEST filed its Cost Allocation Manual ("CAM") with the Commission on March 31, 1988. U S WEST has routinely filed quarterly revisions to its CAM which have been accepted by the Commission. Also, U S WEST has fully complied with the Commission's independent attest and "present fairly" audit requirements which test for carrier compliance; these audits have revealed no significant findings.<sup>18</sup> Finally, U S WEST has been subjected to numerous audits conducted by the Commission staff which have revealed no material instances of cross-subsidization.

Moreover, the financial statements of U S WEST and the dominant interexchange and local exchange carriers are audited by independent public accountants annually. In addition, many of

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<sup>17</sup>Id.

<sup>18</sup>In addition, U S WEST complied with the Commission's Cost Allocation Uniformity Order when it implemented the Commission's uniformity requirements. See In the Matter of Implementation of Further Cost Allocation Uniformity, Memorandum Opinion and Order, 8 FCC Rcd. 4664 (1993).

these companies, including U S WEST, have internal auditing functions that evaluate elements of internal control to ensure that systems are functioning properly and that transactions are being recorded in a manner consistent with management's direction and intent.<sup>19</sup> These audit functions ensure that transactions are recorded appropriately and that the financial statements or other financial reports present fairly the material contained in the company's records.<sup>20</sup>

U S WEST has also established a Technology Fair Compensation Policy as an extra measure to comply with the Commission's cost allocation rules and to ensure that fair compensation is paid by the beneficiaries or users of U S WEST-developed technologies. The policy requires a U S WEST affiliate that desires to use a technology funded by another U S WEST affiliate to pay fair compensation to the funding entity.

Finally, notwithstanding the interstate regulatory oversight by the Commission, U S WEST is subject to intrastate regulatory review by the state commissions within U S WEST's 14-state

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<sup>19</sup>See Statements on Auditing Standards (SAS) #30, The Auditor's Responsibility to Detect and Report Errors and Irregularities, American Institute of Certified Public Accountants (AICPA), compiled at § 642.04(a) of the AICPA Professional Auditing Standards.

<sup>20</sup>See Statements on Auditing Standards (SAS) #1, Responsibilities and Functions of the Independent Auditor, § 110, issued November 1972; SAS #5, The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report § 411, issued July 1975; SAS #43, Omnibus Statement on Auditing Standards, issued August 1982; and SAS #51, Omnibus Statement on Auditing Standards - 1987, issued April 1988, compiled at § 411 of the AICPA Professional Auditing Standards.

region. The safeguards established by these commissions, which serve to protect ratepayers, include, but are not limited to: a) affiliated interest contract review and/or approval in the States of Washington, Oregon, Idaho, Colorado and Arizona; b) asset transfer approval between regulated and nonregulated entities in the States of Washington, Oregon and Arizona; and c) reporting of affiliated interest payables and receivables in the States of Washington, Oregon, Utah, Colorado and Arizona. In addition to the activities of the individual state commissions, the 14 state commissions, within U S WEST's operating territory, have formed a Regional Oversight Committee ("ROC") to study telecommunications issues affecting the region, including affiliated interest matters.

The existing rules, coupled with the additional safeguards presented above, have been effective in providing the necessary protection to ratepayers. U S WEST does not believe, unless the Commission can bring forth substantiated evidence to the contrary, that today's existing rules are insufficient to deter cross-subsidization and therefore need to be changed. The existing rules are and have been sufficient to prevent ratepayer abuse. The proposed rules would impose a significant incremental economic burden on the industry and eventually on the ratepayers for preventative measures which would have no purpose.

IV. REQUIRING A FAIR MARKET VALUATION TEST FOR SERVICES IS IMPRACTICAL AND CREATES INEFFICIENCIES

A. Obtaining Initial Market Prices for Services Provided to Carriers by Nonregulated Affiliates is Not Practical or Feasible Because of the Non-Availability of Pricing Information for Comparable Services

The Notice creates a presumption that services provided by carriers and nonregulated affiliates are discrete, determinable and separable such that comparable services and associated market prices as offered by external providers can be identified in the marketplace. This presumption is not the experience of USWC for transactions between regulated and nonregulated affiliates of U S WEST, as manifested by the results of value studies conducted by USWC.<sup>21</sup> USWC's experience is that fair market value cannot be determined for many services because comparable services are simply not available in the marketplace.

Many services provided to USWC by its nonregulated affiliates are unique for several reasons. First, the quantities of services provided to a carrier of USWC's size are not readily available from just any company. Second, the quality of the services provided by an internal organization is related to its ability to understand and therefore meet the needs of the requesting affiliate. The services an affiliate provides are customized to meet unique needs. This is very apparent in the

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<sup>21</sup>See Exhibit A hereto which details those studies and highlights comments regarding the findings relevant to fair market valuation.

area of technology services, where the work program of U S WEST Advanced Technologies, Inc. ("USWAT"), is tailored to meet emerging market needs. Third, every carrier has a unique service territory with different demographics and population densities. Finally, price is but one element to be considered when making a significant "buy" decision. There are qualitative factors, such as labor relations, flexibility, protection of proprietary information from one's competitors and efficiencies incumbent upon integrated operations, which should be considered.

Given the requirements listed above, finding comparable market data for many services is not possible. Certain services are almost exclusively provided internally. Consequently, prices are not available from non-affiliates in the marketplace. Such services include, but are not limited to, executive management, strategic planning and technology services. The findings of a 1991 Coopers & Lybrand study of Bellcore/USWAT services typify the problem in determining fair market value for technology services.<sup>22</sup> The study found that such services were performed by

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<sup>22</sup>The Coopers & Lybrand study focused on the technical functions of Bellcore and USWAT. The scope of this study included: a) evaluating the marketplace to assess the feasibility of comparing the overall competitiveness of Bellcore and USWAT to organizations that provide or perform services similar to those obtained by USWC from Bellcore and USWAT; b) developing a procedure, based upon the findings from the marketplace evaluation, that would quantitatively compare the performance of Bellcore and USWAT to marketplace organizations providing or performing comparable work; and c) implementing this procedure and drawing conclusions as to the competitiveness of Bellcore and USWAT relative to marketplace organizations.



companies for their internal use only, and, therefore, prices were not obtainable.

Accordingly, U S WEST contends that the Commission's proposed fair market valuation standard cannot be used because with no comparability of services there is no comparability of price.

B. Obtaining Updated Market Price Beyond the Initial Attempt is Impractical Because Competitive Companies are Unwilling to Provide the Information

USWC's experience has been that market valuations are difficult to replicate on an ongoing basis. External service providers have little, if any, incentive to share prices unless they can expect to gain the LEC's business.

The issues surrounding the replication of market values are best typified by two studies performed by Coopers & Lybrand on behalf of USWC to evaluate services performed by U S WEST Business Resources, Inc. In the original study conducted in 1988, Coopers & Lybrand developed and distributed a survey to obtain market prices for procurement-related services and received price information on 23 procurement-related services. In 1990, Coopers & Lybrand was asked to update that study. They contacted the previous survey group, and their experience was as follows:

It was recognized that the major management service companies who participated in the 1988 study would be unwilling to provide the same level of effort and detail as they provided in the original (1988) study.<sup>23</sup>

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<sup>23</sup>1990 Market Pricing Study, U S WEST Business Resources, prepared by Coopers & Lybrand, Oct. 10, 1990, at 2.

Accordingly, USWC's experience indicates that market prices are difficult to obtain and that the availability of information depends greatly upon the cooperation of competitors who provide similar services. Consequently, the constant task of updating market prices would be extremely difficult, if not impossible, to accomplish.

C.    The Proposed Fair Market Value Requirement  
Would Impose Higher Carrier Costs Due to the  
Loss of Economies of Scale in the Provision  
of Affiliate Services

The proposed fair market value rules in the Notice will serve to impede affiliate transactions by instituting economic barriers which dissuade their use. In addition, these economic barriers could thwart U S WEST's efforts to establish the most efficient and effective organizational structures. Under the rules proposed by the Notice, carriers are required to value affiliate services at the lower of fair market value or fully distributed costs ("FDC"). If the services are performed within the regulated carrier, there is no incentive for nonregulated affiliates to utilize these services since the carrier must charge the higher of market or FDC. Nonregulated affiliates would have no incentive to purchase services from the carrier and would either procure these services from the outside market or perform them internally. Consequently, the benefits of economies of scale are lost because the costs of these services cannot be spread over a broader base, resulting in higher costs for the carrier.

Examples of the benefits gained from economies of scale in the provision of centralized services at U S WEST can be found in the reorganizations of legal, internal audit and tax functions and the establishment of centralized purchasing and research organizations. Benefits from the legal reorganization, for example, have demonstrated multi-million dollar annual cost savings to U S WEST, the majority of which accrue to the regulated carrier.

Accordingly, U S WEST believes the Notice could negatively impact future opportunities for these types of efficiencies and cost savings gained through the provision of centralized services across all affiliates.

V. THE COMMISSION'S JUSTIFICATION FOR REQUIRING CARRIERS TO ASCERTAIN FAIR MARKET VALUE FOR SERVICES IS UNFOUNDED

In its Joint Cost proceeding, the Commission adopted separate valuation methodologies for assets and services in cases where affiliate transactions are subject to neither tariff nor prevailing company prices.<sup>24</sup> For assets, carriers are required to record affiliate transactions at the higher of net book cost or fair market value when carriers are the sellers, and at the lower of net book cost or fair market value when carriers are the

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<sup>24</sup>See Notice at 13 ¶ 30.

purchasers.<sup>25</sup> In the case of services, carriers must record affiliate transactions at the providers' FDC.<sup>26</sup>

In the instant proceeding, the Commission proposes to abandon its valuation methodology for services and replace it with an FDC/fair market value test similar to its treatment of assets.<sup>27</sup> The Commission apparently bases this action on the presumption that efficiency incentives driven by price cap regulations "reward imprudent carrier conduct."<sup>28</sup>

The Commission's presumption that its existing valuation method for services motivates carrier imprudence is inconsistent and contradicts the realities of the marketplace. On the one hand, the Commission acknowledges that its price cap regulatory schemes have given the LECs incentives to become more efficient in their operations.<sup>29</sup> On the other hand, the Commission asserts that because of these efficiency incentives its current valuation method for services -- for reasons not supported by any evidence in the Notice -- motivates carriers to engage in imprudent conduct.<sup>30</sup>

U S WEST believes that price cap incentives do exactly the opposite of what the Notice suggests. Price cap programs

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<sup>25</sup>Id. at 11 ¶ 25.

<sup>26</sup>Id. at 13 ¶ 30.

<sup>27</sup>Id. at 15 ¶ 34.

<sup>28</sup>Id. at 14 ¶ 32.

<sup>29</sup>Id. at 13-14 ¶ 31.

<sup>30</sup>Id. at 14 ¶ 32.

mitigate the incentive to shift costs to the regulated company, rather than encourage such practices. The Commission has repeatedly emphasized in its LEC Price Cap proceeding "that price cap regulation will increase carriers' incentives to achieve heightened efficiency, which in turn will lead to lower rates."<sup>31</sup>

VI. PREVAILING COMPANY PRICING SHOULD NOT BE RESTRICTED OR ELIMINATED BY THE COMMISSION AS A VALUATION METHOD

A non-tariffed asset or service is deemed to have a prevailing company price whenever the affiliate that provides the asset or service also provides substantial quantities of the asset or service to non-affiliates. The rules require that when such a price exists the carrier must record the affiliate transaction at that price.<sup>32</sup> The Commission adopted this valuation method based upon the belief that prevailing company prices would provide a reasonably reliable measure of fair market value.<sup>33</sup>

The Commission invites comment on whether it should distinguish among classes of nonregulated affiliates in reevaluating prevailing company prices.<sup>34</sup> The Commission observes that carrier affiliates appear to fall into two classes: those having a primary purpose to serve the carrier and other affiliates, and

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<sup>31</sup>LEC Price Cap Order, 5 FCC Rcd. at 6819 ¶ 266.

<sup>32</sup>Notice at 7-8 ¶ 15.

<sup>33</sup>See generally Joint Cost Order, 2 FCC Rcd. at 1336 ¶ 295; Joint Cost Reconsideration Order, 2 FCC Rcd. at 6296-97 ¶ 125.

<sup>34</sup>Notice at 9 ¶ 19.

those that do not. The Commission tentatively concludes that it should discontinue prevailing company pricing as a valuation method for transactions between carriers and nonregulated affiliates having a primary purpose to serve the carrier and other affiliates because dealings between the carrier and such affiliates are inherently different from arm's-length transactions.<sup>35</sup>

U S WEST maintains that the primary purpose of the affiliate does not determine whether the affiliate's prevailing company price is a reasonably reliable measure of fair market value.

When an affiliate's prevailing company prices are determined by market forces operating in a competitive environment, the affiliate's prices reflect fair market value, regardless of the primary purpose of the affiliate. For instance, an affiliate whose primary purpose is to serve the carrier can sell some of its products and services in a competitive market environment, thereby establishing a prevailing company price which is the fair market value of such products and services. Accordingly, U S WEST believes that the Commission's present "substantial" test for establishing prevailing company prices is appropriate.

The Commission maintains that a "bright line" test is required to establish that an affiliate's predominant purpose is to serve non-affiliates, and, therefore, prevailing company prices can be used as a valuation method for affiliate transactions. The Commission proposes that this determination be made based upon the seventy-five percent (75%) of output test. The

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<sup>35</sup>Id.

generally-accepted definition of "fair market value" is the amount at which property would be exchanged between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts.<sup>36</sup> From that definition, it is clear that the purpose for the existence of the seller or buyer has absolutely nothing to do with fair market value. The only issue that matters in ascertaining whether prevailing company prices represent the fair market value of goods and services is the environment in which the prices were set.

If the environment is competitive so that buyers are under no compulsion to buy, they have reasonable knowledge of relevant facts about the affiliate's product or service, and they are willing and, in fact, do buy the affiliate's product or service at its prevailing company price, then the price is, by definition, set at fair market value. Accordingly, the only factor that should determine whether prevailing company prices are set at fair market value is whether a buyer in a competitive market buys any of the products or services at prevailing company prices. Moreover, a single sale of a product or service to an independent third party at prevailing company price should be sufficient to establish that the price is set at fair market value.

However, an argument could be made that an isolated sale to a single customer could be aberrant; the buyer might pay an

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<sup>36</sup>Black's Law Dictionary 537 (5th ed. 1979).

above-market price due to extenuating circumstances. Accordingly, the Commission could consider promulgating a rule that a sale to some minimum threshold number of third-party customers (such as three) would be required to establish that prevailing company prices represent fair market value.

In this respect, sales to a minimum number of outside customers establish that prevailing company prices are set at fair market value. But, the converse is not necessarily true. Sales to less than a threshold number of outside customers do not prove that prevailing company prices are not set at fair market value. As a matter of fairness, U S WEST recommends that the Commission adopt a rule that would permit a carrier to overcome that doubt with other sufficient evidence to show that prices are at fair market value. This rule should not be burdensome to the Commission or carriers because it would be employed only where a carrier believed sufficient evidence existed to show that prices are set at fair market value.

The Commission also invites comment on the use of prevailing company prices between affiliates in light of the potentially close relationship between affiliates.<sup>37</sup> The Commission notes that companies in competitive markets devote extensive resources to retaining and attracting customers. The Commission states without substantiation or proof that sales between affiliates usually do not require extensive marketing efforts and generally

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<sup>37</sup>Notice at 8-9 ¶ 18.



involve lower transactional costs.<sup>38</sup> The Commission questions whether affiliate transactions are sufficiently similar to transactions among non-affiliates to justify the continued use of prevailing company prices as a valuation method for affiliate transactions.<sup>39</sup>

The Commission's question is perplexing because its premise is that use of prevailing company price to value affiliate transactions can be justified only if they are "sufficiently similar" to transactions involving non-affiliates.<sup>40</sup> The question implies that if the transactional cost of transactions between affiliates is lower than the transactional cost of transactions between non-affiliates, use of prevailing company price is not justifiable. Likewise, it implies that if the relationship between a non-affiliated buyer and seller is not as close or as long term as that of an affiliated buyer and seller, use of prevailing company price is not justifiable.

This line of reasoning defies logic. It erroneously assumes that if transactions or relationships between affiliates are somehow superior to those between non-affiliates, use of prevailing company price is not justifiable, regardless of whether it represents fair market price. The Notice never explains how ratepayers might be disadvantaged or unfairly burdened by bearing costs paid at prevailing company prices that are equal to fair

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<sup>38</sup>Id.

<sup>39</sup>Id.

<sup>40</sup>Id.